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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1155

ESTATE OF WILLIAM S. HULL, DECEASED, MESSRS.
JONATHAN W. HULL AND WILLIAM HAROLD
CARPENTER, SURVIVING EXECUTORS,
Petitioner,

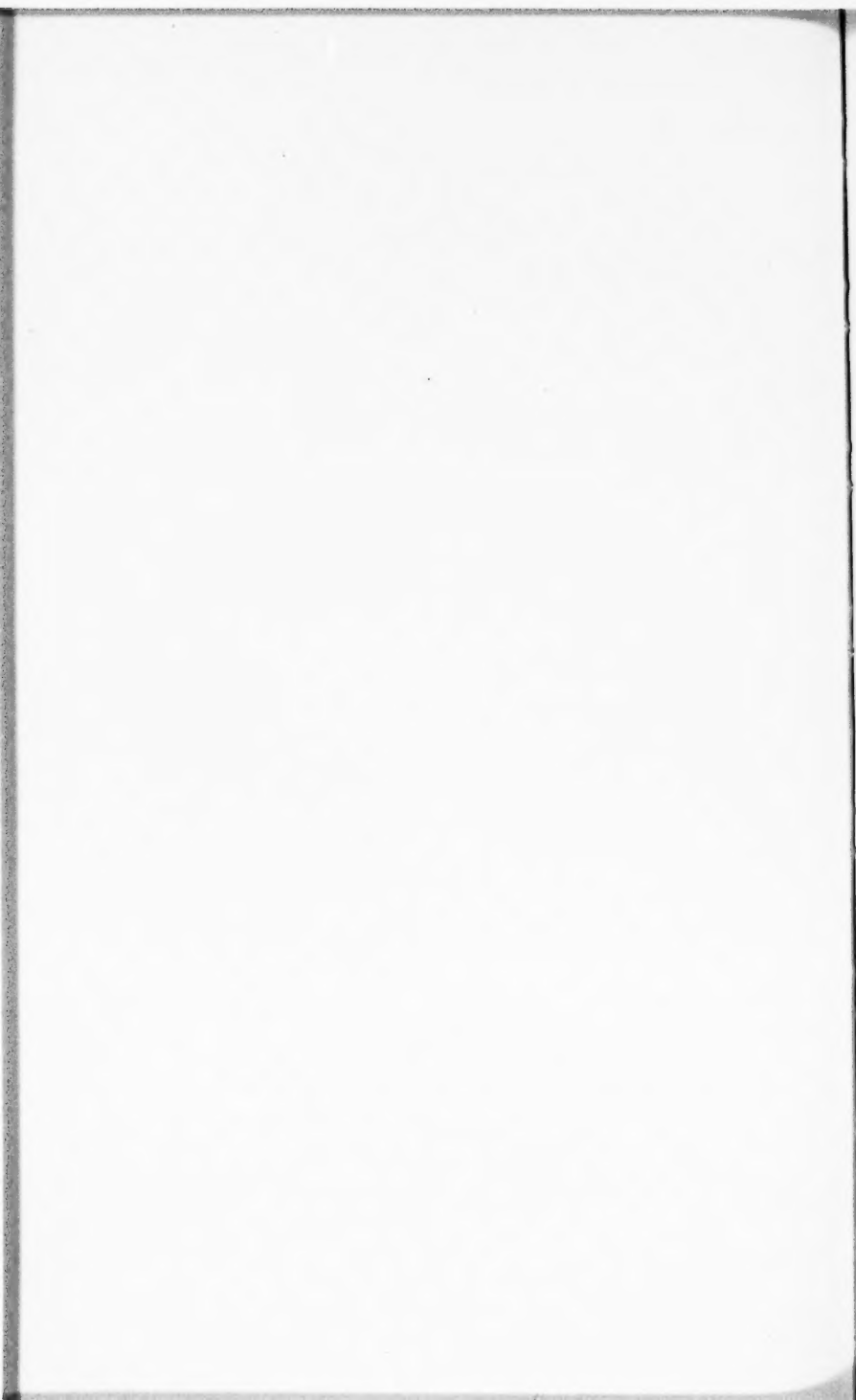
vs.

COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT AND BRIEF IN SUP-
PORT THEREOF.

AARON FRANK,
Counsel for Petitioner.

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CHARLES J. EIGNOR,
Of Counsel.



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JONATHAN W. HULL AND WILLIAM HAROLD
CARPENTER, SURVIVING EXECUTORS,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT.**

To the Supreme Court of the United States and the Honorable Justices thereof:

The petition of the Estate of William S. Hull, deceased, Messrs. Jonathan W. Hull and William Harold Carpenter, surviving executors, praying for a writ of certiorari with respect to the judgment of the United States Circuit Court of Appeals for the Second Circuit, entered the 23rd day of

January, 1942, and in support thereof, respectfully shows to this Honorable Court:

A.

Summary Statement of the Matter Involved.

In the preparation of his Federal Income Tax return for the year 1936, William S. Hull (who, having died in 1938, is hereinafter referred to as decedent), the owner of one-third of the issued and outstanding capital stock of Primal Realty Corporation, a New York Corporation (hereinafter referred to as Primal), deducted the sum of \$18,200. as a loss due to the worthlessness of his stock holding. The deduction was disallowed by the Commissioner of Internal Revenue and a deficiency was assessed in the sum of \$3,961.21.

On August 12, 1940, the Board of Tax Appeals, passing upon a petition for redetermination of the deficiency affirmed the determination of the Commissioner. Its decision is not reported (R. 13-22). On January 23, 1942, the Circuit Court of Appeals, Second Circuit, passing upon a petition to review the decision of the Board of Tax Appeals, entered its judgment of affirmance. The written opinion is reported in 124 F. (2d) 503.

The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

The surviving executors of the Estate of William S. Hull, deceased, were permitted by order made by the Circuit Court of Appeals for the Second Circuit, on the 16th day of April, 1941, to continue and prosecute the appeal to that Court without prejudice to the proceedings already had or taken (R. 98-100).

The question presented herein is whether the Circuit Court of Appeals for the Second Circuit erred in failing to

reverse the determination of the Commissioner and the decision of the Board of Tax Appeals and to find that upon the evidence the loss was sustained in 1936, the year claimed by decedent.

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 29-31.

Primal was incorporated in 1929 with an authorized capital stock of \$54,600. All of the stock was issued for cash at its par value of \$100. per share—182 shares to decedent, 182 shares to O. D. & H. V. Dike (a corporation formed by Oscar Dike and Herbert V. Dike) and 182 shares to Frank Titchenor (R. 13).

Shortly after its incorporation Primal purchased six parcels of real estate constituting a corner property and known by the street numbers 2120, 2122, 2124, 2126 and 2128 Eighth Avenue and 280 West 115th Street, in the Borough of Manhattan, City of New York. The cost to Primal was \$157,500; \$54,600. in cash and \$102,900. in mortgages to which the various properties were held subject (R. 13).

Decedent owned two mortgages, each for \$15,000. on Nos. 2120 and 2126 Eighth Avenue; one mortgage for \$22,000. on No. 2128 Eighth Avenue and one mortgage for \$12,000 on No. 280 West 115th Street, making his total holding of mortgages \$64,000. A mortgage for \$15,000. on No. 2122 Eighth Avenue was held by Mrs. Audrey Woodward, and a mortgage of \$16,000. on No. 2124 Eighth Avenue was held by Church of the Incarnation (R. 14). There was a blanket second mortgage on the five parcels on Eighth Avenue which was subsequently paid (R. 15).

The properties were improved, the five on Eighth Avenue each with a six story tenement on a plot 100 feet by 100 feet, with stores on the ground floor and apartments above, and the lot on 115th Street with a store on the ground floor and apartments above; all were old law tenements (R. 14).

The buildings were profitable during the first year that Primal owned them and the latter was able to pay off the second mortgage out of the revenues, leaving the other six mortgages aggregating \$95,000. wholly unpaid (R. 35). With the general depression which started in the early 1930's conditions changed and the property became less productive. They were unable, ultimately, to produce sufficient income to meet the carrying charges, taxes and interest, resulting in a net annual loss in the years 1933 to 1937 inclusive (R. 17).

The Dike Corporation was the managing agent for the properties from the time of their acquisition. The income from all of the properties was commingled in one account by the managing agent and disbursements on account of all of the parcels were made from such account (R. 34).

In 1935, the property had ceased to earn sufficient to pay all of the carrying charges. Church of the Incarnation demanded an assignment of the rents of No. 2124 Eighth Avenue upon which it held a mortgage. Such assignment was made (Pet. Ex. 12, R. 78-84). An assignment was also made of the rents of the property 2122 Eighth Avenue to Mrs. Audrey Woodward, holder of the mortgage upon that property. It is not certain whether the latter assignment was made in 1935 or 1936.

No assignment of rents of the properties upon which decedent held four mortgages was made until 1936. Taxes on all the properties, amounting to \$18,892.95 at the end of 1936, were in arrears; also interest on the mortgages (R. 17). The corporation was unable to meet these arrears, and upon insistence by the decedent an assignment of rents of the properties upon which he held his four mortgages was made in 1936. This assignment was oral. In the same year decedent paid the arrears of taxes on the properties upon which he held mortgages (R. 44, 45).

Subsequent to the rental assignment to decedent, the managing agent kept separate accounts of receipts and disbursements of each parcel of property and accounted to the respective mortgagees therefor. With the year 1936, Primal ceased to exercise control over the properties and possession thereof was, for practical purposes, in the hands of the respective mortgagees. It was not deemed necessary that decedent should foreclose his mortgages "because he was in the position, if he asked any time, he could have gotten a deed for the property" (R. 45). Oscar Dike offered to give decedent all the stock of Dike interests, but decedent refused to accept it, because he thought that it might involve him in the other two pieces of property. "He considered that there was no value above the mortgages, and he did not want to involve himself at all. He considered the stock worthless and had forgotten it" (R. 45, 46). Dike testified that "that conversation was held some time during 1936" and that it was "all after the thing had been turned over to him" (R. 46).

In 1936 fire retarding violations were issued against the properties, pursuant to the Multiple Dwelling Law of the State of New York. The cost of making the necessary repairs to comply with the violations filed against the properties upon which decedent held mortgages was about \$8,000. (R. 46). The necessary repairs and alterations were made in different years, one house was not finished until 1939; on some of the others work was completed in 1938, and some in the latter part of 1937 (R. 47).

The fair market value, in 1936, of all of the properties acquired by Primal was \$92,000 (as a contiguous corner property). This value was likewise reflected in 1933, 1934 and 1935 (R. 51).

Primal's liabilities on December 31, 1936, aggregated \$118,481.32, of which \$95,000. represented the principal indebtedness on the mortgages and \$23,481.32 represented

arrears in interest and taxes. (Pet. Ex. 4, R. 57). The cost of compliance with the violations filed would have increased the liabilities in the sum of \$12,000. The cash reflected on Primal's balance sheets as of December 31, 1936, was evidently held for the account of decedent.

Three identifiable events occurred in 1936 which justified decedent's determination in that year that his stock holding in Primal was worthless: (1) Primal's assignment of rents to decedent on the properties upon which decedent held mortgages, representing the final relinquishment by Primal of its property; (2) decedent's payment of taxes in arrears by reason of Primal's inability to satisfy them; and (3) the issuance of violations which Primal was unable to remove.

The Commissioner of Internal Revenue took the view that Primal was a going concern in 1936 and that no identifiable event occurred in that year "such as foreclosure of mortgages, receiverships, etc. which would definitely and permanently place the loss within such period" (R. 10).

The Board of Tax Appeals sustained the disallowance of the claimed loss *but it made no finding that Primal "was still a going concern" in 1936*. The Board of Tax Appeals indicated that it might be difficult to arrive at the conclusion that a mere assignment of rents justifies an inference of abandonment; but it placed the basis for its refusal to regard the assignment to decedent as an identifiable event on the ground that the assignment was made in 1935 and not in 1936. The Board found that decedent paid the arrears in taxes in the year 1936 and that violations were issued in that year requiring an expenditure of about \$8,000. upon the properties on which decedent held mortgages. It did not, however, regard these facts as identifiable events indicating that reasonable hope and expectation of value at some future time had been foreclosed.

The insolvency of Primal was deemed a condition which existed for a number of years.

In its opinion of affirmance the Circuit Court of Appeals, Second Circuit, found that the rent assignment to decedent was made in 1936. It found that Primal was insolvent in 1936 and also prior thereto. The Appellate Court determined that there was no intention to abandon the property and that *Primal* "*was still a going concern in 1936.*"

B.

Reasons Relied On for the Allowance of the Writ.

1. The Circuit Court of Appeals for the Second Circuit erred in holding that *Primal* was still a going concern in 1936, since the testimony shows that the corporation relinquished some of its properties in 1935 and the balance in 1936, leaving it without assets to pay arrears in taxes and to pay the cost of making the alterations required pursuant to the violations which had been issued. Mere existence of the corporation, and even the carrying on of corporate functions, are not factors which enter into a determination of the question whether a stockholder was justified in giving up his hope and expectation of salvaging some value out of his stock holding.

2. The Circuit Court of Appeals made conflicting and inconsistent findings in that it determined (a) that decedent's stock became worthless before 1936 and (b) that decedent's stock did not become worthless in 1936 because there was no intention to abandon the corporate property and the corporation was still a going concern in 1936.

3. The decision rendered by the Circuit Court of Appeals conflicts with the findings of the Board of Tax Appeals in that (a) the Board of Tax Appeals did not find that the corporation was still a going concern in 1936 and (b) the Board of Tax Appeals found that the assignment of rents to the decedent was made in 1935 while the Circuit Court of Appeals found that the assignment was made in 1936.

4. The Circuit Court of Appeals erred in holding that the Commissioner's determination and the decision of the Board of Tax Appeals were sustainable upon the evidence.

5. The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals and in holding that the Board of Tax Appeals had substantial evidence to support its finding that the stock did not become worthless in 1936.

6. The Circuit Court of Appeals erred in determining that there was no intention to abandon the Primal property in 1936 since abandonment took place in fact.

7. The Circuit Court of Appeals erred in considering, as a separate and independent factor, Primal's insolvency prior to 1936. While insolvency of a corporation may be a necessary element in establishing the worthlessness of the corporate stock, it is only one factor to be considered and its occurrence in a particular year is immaterial, unless there is linked with it such fact or facts which indicate that there is no reasonable hope or expectation of the realization of value, at some future time, from the corporate stock. To consider insolvency prior to 1936, as an independent factor, and as the controlling factor, would impose upon the taxpayer the obligation of foreseeing with accuracy the occurrence of future events.

8. The Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals in that the latter relied principally upon its finding that the rent assignment to decedent was made in 1935, whereas the testimony establishes clearly that it was made in 1936, and the Circuit Court so found. The principal finding made by the Board is, therefore, without substantial evidence to support it.

9. The effect of the findings, rulings or opinions (1) that Primal was still a going concern in 1936, and (2) that the

conditions upon which decedent relied in taking his stock loss had existed for a number of years (indicating the possible propriety of a deduction prior to 1936) is to place the taxpayer in the position of being denied the right to deduct the loss—a right which is granted under the taxing statutes. Treasury Regulations 94, promulgated under the Revenue Act of 1936, Article 23 (e-1), state that “Substance and not mere form will govern in determining deductible losses.” If the ruling in the instant case is permitted to stand, it will amount to a construction of these Regulations to the effect that a determination by the Commissioner against the weight of evidence estops the taxpayer and deprives him of his property without due process of law. If the ruling is permitted to stand it will lead to the result that a taxpayer may be penalized for his inability to foresee with absolute accuracy the precise moment when his investment becomes worthless. It would tend to lead to a disregard of the realistic view of a tax situation. The hollow shell of corporate existence—*mere form*—would be deemed paramount to substance, as evidenced by the relinquishment of corporate property in 1936, decedent’s payment of tax arrears in 1936, and the issuance of violations against the corporate property, which Primal was unable to remove.

10. It is submitted that the Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals upon the “substantial evidence” rule, since the Board’s decision was against the weight of evidence. It was not the intent of Congress, in passing the taxing statutes, to grant to the Board power to make a finding contrary to the weight of evidence; nor do the decisions hold that the determination of the Commissioner is “presumptively correct” if such a determination was made against the weight of evidence.

11. Under a virtually similar taxing statute the Appellate Division of the Supreme Court of the State of New York, Third Department, decided that the loss which decedent suffered by virtue of his stock holding in Primal was properly deducted in the year 1936. The decision was rendered on January 7, 1942, and it is reported in *People ex rel. Hull v. Graves*, 263 N. Y. App. Div. 223. (An appeal therefrom, by the State Tax Commission of the State of New York is presently pending in the New York Court of Appeals).

12. The Commissioner of Internal Revenue and the Board of Tax Appeals erred, and the Circuit Court of Appeals erred in affirming the decision of the Board of Tax Appeals, in that the Board and the Commissioner limited the nature of an identifiable event to foreclosure of mortgages, receiverships, bankruptcy, suspension of business, or liquidation. There is no requirement that a corporation must divest itself of title to its real property by liquidation or otherwise in order to sustain a claim that its capital stock is worthless.

13. The Circuit Court of Appeals and the Board of Tax Appeals failed to consider an array of facts which, together with proper inferences to be drawn therefrom, amply justified the deduction made by decedent.

WHEREFORE your petitioner respectfully prays that this petition for writ of certiorari to the Circuit Court of Appeals for the Second Circuit, to review the judgment of said Circuit Court of Appeals in this case, be granted.

ESTATE OF WILLIAM S. HULL,

Deceased,

JONATHAN W. HULL,

WILLIAM HAROLD CARPENTER,

Surviving Executors,

By AARON FRANK,

Attorney for Petitioner.